No. 618

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

ESTATE OF HENRY H. ROGERS, deceased, ALBERT STICKNEY and CENTRAL HANOVER BANK AND TRUST COMPANY, as Surviving Executors of the Last Will and Testament of HENRY H. ROGERS, deceased, *Petitioner,*

against

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

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Dated, New York, N. Y., October 20, 1944.

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TO THE HONORABLE THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The Estate of Henry H. Rogers, Albert Stickney and Central Hanover Bank and Trust Company, as surviving executors, petitions for a Writ of Certiorari to review the decision of the Circuit Court of Appeals for the Second Circuit in its judgment entered on July 24, 1944, which affirmed a decision of the Tax Court of the United States entered on March 31, 1943, sustaining in part a deficiency in Federal income taxes for 1937 asserted by the Commissioner of Internal Revenue.

Summary Statement of the Matter Involved

The three issues involved relate solely to the method of taxing what is concededly capital gain. There is no question of tax evasion, but only when the gain should be taxed, to whom, and at what holding period rate.

The executors of the petitioner Estate sold in 1937 certain stock forming a part of the Estate, for a consideration more than 70% of which consisted of collateral trust serial notes of the purchasing corporation. In the Estate's income tax return the executors elected to report the gain on the installment basis; the Tax Court has held this proper, and no appeal was taken from its holding on this point.

Later in 1937 the executors caused some of the notes to be eliminated from their accounts as executors and entered upon their accounts as residuary trustees under the decedent's will, and caused other notes to be allocated to an escrow agent for a residuary legatee. The Commissioner of Internal Revenue, by an amended answer in the Tax Court, contended that these bookkeeping transactions constituted a distribution, transmission, sale or other disposition of these notes within the meaning of Section 44(d) of the Revenue Act of 1936, and that accordingly, the entire gain represented by these notes became taxable to the Estate in 1937, producing a deficiency in income tax for that year of $487,053.58.

Against the point raised in the Commissioner's answer, petitioner made three contentions, upon which it still relies: first, that the shift of the installment obligations from one account to another not only was not the type of event which Congress intended to reach in Section 44(d), but also was not an event of sufficient substance to justify the imposition of any income tax; second, that even if an event of the type specified in Section 44(d) did take place, and an immediate capital gain "resulted" to petitioner in 1937, petitioner is entitled to deduct the amount of gain as an amount of income properly paid to legatees under Section 162(c) of

the Revenue Act of 1936; and third, that if a gain was realized by petitioner by reason of such alleged distribution, the proper holding period, for the purpose of determining the percentage of such gain to be taken into account under Section 117(a) of the 1936 Act, was not merely the period during which the executors had held the original stock received from the decedent, but consisted of the period from the decedent's death to the date the notes into which the stock had been converted were transferred to the trusts and the residuary legatee.

The Tax Court held against the petitioner on all three contentions, and the Circuit Court of Appeals affirmed.

Statutes Involved

The statutes involved in this case are the following provisions of the Revenue Act of 1936 (c. 690, 49 Stat. 1648; 26 U. S. C. A. 813):

Section 44(d):

> "(d) *Gain or Loss upon Disposition of Installment Obligations.*—If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and (1) in the case of satisfaction at other than face value or a sale or exchange—the amount realized, or (2) in case of a distribution, transmission, or disposition otherwise than by sale or exchange—the fair market value of the obligation at the time of such distribution, transmission, or disposition. Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received. The basis of the obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full. This subsection shall not apply to the transmission at death of installment obligations if

there is filed with the Commissioner, at such time as he may by regulation prescribe, a bond in such amount and with such sureties as he may deem necessary, conditioned upon the return as income, by the person receiving any payment on such obligations, of the same proportion of such payment as would be returnable as income by the decedent if he had lived and had received such payment."

Section 162(c):

"(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary."

Section 117(a):

"(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income: * * *

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years; * * *."

Questions Presented

1. Did the petitioner distribute, transmit, sell or otherwise dispose of certain installment obligations during the year 1937 within the meaning of Section 44(d) of the Revenue Act of 1936?

2. Assuming the petitioner did distribute, transmit, or otherwise dispose of the installment obligations in 1937 to residuary trusts created under the will of petitioner's decedent and to a residuary legatee, is the petitioner entitled to deduct the amount of gain thereby resulting as an amount of income properly paid to legatees under the provisions of Section 162(c) of the Revenue Act of 1936?

3. Assuming the petitioner did realize a gain from the allocation of the installment obligations to the residuary trusts and the residuary legatee in 1937, does the proper holding period, for the purpose of ascertaining the percentage of gain to be taken into account in computing net income under Section 117(a) of the Revenue Act of 1936, include not only the time the Estate held the original stock, but also the time it held the notes into which the stock was converted?

Statement of This Court's Jurisdiction to Review

The judgment of the Circuit Court of Appeals was entered on July 24, 1944. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (c. 229, 43 Stat. 938; 28 U. S. C. A. § 347(a)).

Reasons Why the Writ of Certiorari Should Be Issued

I. *As to the question of a "distribution" under Section 44(d).*

In holding that the shift of the notes from the executors' accounts to the trustees' accounts was a distribution of the notes for income tax purposes, the Circuit Court of Appeals decided a Federal question in a way probably in conflict with applicable decisions of this Court.

The decision of the court below on this issue conflicts in principle with *Brewster* v. *Gage*, 280 U. S. 327 (1930);

Maguire v. *Commissioner*, 313 U. S. 1 (1941); *Helvering* v. *Gambrill*, 313 U. S. 11 (1941); *Helvering* v. *Campbell*, 313 U. S. 15 (1941); *Helvering* v. *Reynolds*, 313 U. S. 428 (1941); and *Cary* v. *Commissioner*, 313 U. S. 441 (1941), and the view of the Circuit Court of Appeals that its decision was controlled by *Helvering* v. *Gambrill* arises from an erroneous interpretation of what was decided in that case. These cases show that a remainderman acquires his interest in estate property, and that the property is distributed to him, at the time the executor acquires it; in the present case, however, the tax has been sustained on the theory that a "distribution" was made at a later date, by bookkeeping entries.

In the *Maguire, Gambrill, Campbell, Reynolds* and *Cary* cases, all decided in 1941, this Court made a careful and comprehensive analysis of the question of when, for income tax purposes, a remainderman under a testamentary trust acquires his interest either in the decedent's property or in assets purchased by an executor or trustee with estate funds. In each case, the remainderman asked this Court to decide that the time of acquisition by him was the date the testamentary trustee actually delivered the property into his hands. In all five cases this Court, integrating its holdings with the fundamental doctrine already laid down in *Brewster* v. *Gage*, refused so to rule, and held that Congress, with one exception, had singled out the date of decedent's death or the date of the fiduciary's purchase as the crucial point of time as of which the remainderman should be deemed to have acquired his interest in the property for income tax purposes. Forced to qualify its general rule because of the special provision of the 1928 and 1932 Revenue Acts for determining the basis of general bequests of personalty, the Court gave effect to this Congressional exception for the years these Acts were in force and held that for this one limited purpose the focal transaction was the transfer from executor to testamentary trustee.

In *Maguire* v. *Commissioner* this Court recognized an important and necessary corollary to the meaning of the word "acquisition" as applied to a remainderman, by hold-

ing that for income tax purposes "acquisition" and "distribution" occur simultaneously. In other words, a remainderman has property distributed to him at the time he acquires his interest therein. Accordingly, since the focal date adopted by Congress in the 1934 and later Acts is either the date of death or the date of the fiduciary's purchase, transfers between fiduciaries in the course of effectuating a decedent's wishes subsequent to the one time that is crucial for income tax purposes are without significance and must be disregarded. As applied to the present situation, this means that the three residuary trusts and the residuary legatee had the notes distributed to them at the moment the notes were acquired by the executors, and that all later transfers in the chain of devolution were without any income tax significance. In this connection, it should again be noted that the present case is governed by the 1936 Act, which embodies the general rule, and not by the 1932 Act, which was the last statute to contain the special exception.

The court below, in seeking guidance from these decisions as to the proper interpretation of "distributed" in Section 44(d), apparently allowed itself to be unduly influenced by the fact that its decision in *Commissioner* v. *Gambrill*, 112 Fed. 2d 530 (C. C. A. 2d, 1940), was reversed by this Court. It failed to recognize that this Court, in deciding the *Gambrill* case, attributed a special income tax significance to the transfer of property from executors to trustees only to the extent required by the particular change made in the Revenue Acts of 1928 and 1932 for determining the basis of a general bequest of personalty, and that this 1928-1932 change was only a "limited departure" (313 U. S., p. 8) from the general rule as to basis obtaining prior to 1928 and re-adopted by Congress in the 1934 Act. *Maguire* v. *Commissioner*, and *Helvering* v. *Reynolds*, *supra*. The decision below, therefore, is out of line with the principles so carefully and fully laid down by this Court in the five cases decided in 1941.

In its holding on this first issue, moreover, the Circuit Court of Appeals has decided an important question of

Federal law which so far has not been passed upon by this or any other court, save in this proceeding, and which should be settled by this Court. Inasmuch as the point decided is entirely new and is of great importance in the administration of decedents' estates, in so far as that activity is subject to Federal income tax, it is essential for the proper functioning of the Internal Revenue Laws that the point decided should be settled by this Court, both for the information of all concerned and to avoid further litigation.

II. *As to the question of a deduction under Section 162(c).*

In ruling against petitioner's contention that if a capital gain resulted petitioner was entitled to deduct it as income properly paid or credited to legatees, the Circuit Court of Appeals again decided a Federal question in a way probably in conflict with an applicable decision of this Court.

The decision of the court below on this issue conflicts with *Helvering* v. *Butterworth*, 290 U. S. 365 (1933). In that case a testamentary trustee, having paid income of the trust to the decedent's widow, claimed a deduction therefor, under Section 219 (b) of the Revenue Act of 1924, as an amount of trust income which was to be distributed currently by the fiduciary to the beneficiary. In support of his disallowance of this deduction, the Commissioner contended that the widow had elected to accept the provisions of the trust in lieu of her statutory rights in the decedent's estate, and hence that the payments to her could not be taxed to her or deducted by the trustee until they had amounted to the value of what she had relinquished. This was the equivalent of a contention that the widow had received the amounts in question as exempt corpus rather than as taxable income. This Court refused to adopt the Commissioner's contention, and thus in effect ruled that the character of a payment as income does not change as it passes through the hands of a fiduciary, but remains taxable to the actual ultimate recipient thereof.

The effect of the decision of the court below is to tax the capital gain here involved to the persons who distributed it instead of to the persons who received and retained it. This erroneous result arises from the concept that the capital-gain component of the installment obligations somehow loses its character as income when transferred from one fiduciary to another. *Helvering* v. *Butterworth* held that Congress intended otherwise, and the decision below is in direct conflict therewith.

The warning in the *Butterworth* case to the effect that a tax statute and the will of Congress are under inquiry casts considerable doubt, moreover, upon the propriety of the lower court's dependence in this case upon the language of the decedent's will in the light of local New York decisions and the accounting procedures which took place thereunder. This Court, in *Lyeth* v. *Hoey*, 305 U. S. 188 (1938), *Burnet* v. *Harmel*, 287 U. S. 103 (1932) and other cases, has held that where the meaning of words and concepts used in a Federal statute is involved, Federal law has its own criteria, and local laws are without controlling effect. It is peculiarly appropriate here that Federal criteria should control, inasmuch as the type of capital gain said to result in this case is not the usual one resulting from the ordinary sale of assets but is a specially accelerated gain engendered by the unique provisions of Section 44(d). By failing to approach this as an original Federal question, the court below fell into an error which should be corrected here.

Here again, the decision of the court below on this second issue raises an important question of Federal law which so far has not been passed upon in a case where installment obligations are involved by any tribunal, except in this proceeding. This issue is new so far as installment obligations are concerned, although the Commissioner himself has reached the result we contend for in a published ruling. I. T. 2589, C.B. December, 1931, page 156. Various Circuit Courts, attempting to apply this Court's decisions in

Burnet v. *Whitehouse,* 283 U. S. 148 (1931), *Freuler* v. *Helvering,* 291 U. S. 35 (1934), and other cases passing on Section 162 or its counterparts in the various Revenue Acts, have reached divergent views as to when a capital gain realized by an executor or trustee may be deducted by such fiduciary when distributed to a beneficiary. Although the divergence may be explained by the disposition of the various Circuit Courts to rest their decisions upon local laws which vary from jurisdiction to jurisdiction,* the result is great confusion in the application of the Federal income tax to decedents' estates in the course of administration. This confusion might well be obviated by this Court's reexamining the whole question of whether the character of income is affected by its passing through the hands of a fiduciary, so far as its ultimate taxability to the beneficiary is concerned.

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* See *Weigel* v. *Commissioner,* 96 Fed. 2d 387 (C. C. A. 7th, 1938); *County National Bank & Trust Co.* v. *Helvering,* 122 Fed. 2d 29 (C. A. D. C., 1941); *Anderson's Estate* v. *Commissioner,* 126 Fed. 2d 46 (C. C. A. 9th, 1942); *Commissioner* v. *Crawford's Estate,* 139 Fed. 2d 616 (C. C. A. 3d, 1943); *Commissioner* v. *Bishop Trust Co.,* 136 Fed. 2d 390 (C. C. A. 9th, 1943); *Weber* v. *Commissioner,* 111 Fed. 2d 766 (C. C. A. 2d, 1940). Most of these cases rely on a dictum of *Burnet* v. *Whitehouse, supra,* that the predecessor of Section 162 applies "only to income paid as such to a beneficiary" (283 U. S., p. 151). From this they deduce the further rule that whether income is "paid as such" is a matter of local law. We submit that no such inference is required by the *Whitehouse* case. The question there involved was whether an annuity charged against a whole estate was exempt from tax under the predecessor of Section 22(b)(3) as a bequest of corpus. The dictum was in answer to an attempt of the Commissioner to integrate Section 22(b)(3) with Section 162.

III. *As to the question of holding period under Section 117(a).*

In restricting the applicable holding period (for the purpose of determining the percentage of gain to be taken into account) to the period during which the executors held the original stock, the court below decided an important Federal question which has not been but should be decided by this Court. The court below, apparently thinking that Section 44(d) was not clear, permitted itself to be governed exclusively by a statement in the Congressional Committee Reports; and it gave no effect to the explicit statutory direction that on disposition of an installment obligation gain or loss "shall result", and that "Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received." Under this plain language we submit that the holding period begins with the date the original property was acquired by the executors and ends with the disposition by the executors of the obligations into which the original property has been transformed. Again, this is a question of general importance in the administration of the Federal revenue laws which has not been passed upon by this or any other court, except in this proceeding.

Prayer

For the foregoing reasons, your petitioner prays that a writ of certiorari be issued out of this Court to the United States Circuit Court of Appeals for the Second Circuit, commanding said court to certify and send to this Court, on a day to be determined, a full and complete transcript of the record of all of the proceedings of said Circuit Court of Appeals had in this case, to the end that this cause may be reviewed and determined by this Court; that the judgment of the Circuit Court of Appeals be reversed with re-

spect to the decision of the issues here presented; and that petitioner be granted such other and further relief as may be proper.

Estate of Henry H. Rogers, *Deceased*,
Albert Stickney and Central Hanover Bank and Trust Company, *as Surviving Executors, Petitioner*,

John W. Drye, Jr.,
Counsel for Petitioner.

Dated: New York, N. Y., October 20, 1944.